

DIRECT TESTIMONY

of

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Rockwell Utilities, LLC

Application for Approval of a Reorganization Pursuant to Section 7-204 of the Illinois
Public Utilities Act and for all other relief

Docket No. 11-0212

July 14, 2011

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1 **Witness Identification**

2 **Q. Please state your name and business address.**

3 A. My name is Mary H. Everson. My business address is 527 East Capitol Avenue,
4 Springfield, Illinois 62701.

5 **Q. Please describe your professional background and affiliations.**

6 A. I have a Bachelor of Science in Accounting from the University of Central Florida.
7 I am a Certified Public Accountant licensed to practice in the State of Illinois. I
8 joined the Staff of the Illinois Commerce Commission ("Staff") in February 1999.
9 Prior to joining Staff, I was employed in industry as a financial analyst and in
10 government as an internal auditor.

11 **Q. Have you previously testified before any regulatory bodies?**

12 A. Yes. I have testified on several occasions before the Illinois Commerce
13 Commission ("Commission")

14 **Q. What is the purpose of your testimony in this proceeding?**

15 A. The purpose of my testimony is to present my position on the Applicants'
16 Rockwell Utilities, LLC's ("Company" or "Rockwell") application for approval of a
17 sale of 100% of the membership interest in the Company to Rockwell
18 Investments, LLC ("RI"). Specifically, my testimony addresses Sections 7-
19 204(b)(2), (3) and 7-204(c) of the Illinois Public Utilities Act ("Act") with respect to
20 the reorganization application. I am also addressing the proposed affiliate

agreement, the proposed accounting entries, and the pro forma statements of income for the water and sewer utility operations.

Section 7-204(b)(2) and (3) of the Act

Q. What are the requirements of Sections 7-204(b)(2) and (3) of the Act?

A. Section 7-204(b)(2) states in relevant part that:

In reviewing any proposed reorganization, the Commission must find that ... the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers[.]

Section 7-204(b)(3) states in relevant part that:

In reviewing any proposed reorganization, the Commission must find that ... costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes[.]

Q. What recommendation do you propose for the Commission to make regarding the findings required under Sections 7-204(b)(2) and (3)?

A. I recommend that the Commission approve the proposed affiliate agreement with two language revisions and two conditions. With an approved affiliate agreement, I recommend that:

(1) the Commission find that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers and

(2) the Commission find that costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the

Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes.

Q. On what basis are you making this recommendation?

A. The affiliate interest agreement provided as Rockwell Exhibit 1.4 with the two language revisions and the two conditions that I propose should provide sufficient safeguards to ensure that ratepayers do not subsidize the operations of the utility's affiliate or that costs and facilities that are considered for ratemaking purposes are appropriate for recovery. Rockwell's Application states that if the reorganization is approved by the Commission, Rockwell will enter into a contract with RI with substantially similar terms as the current Commission-approved agreement. In direct testimony, Rockwell states that if the Commission approves the reorganization, it will enter into a contract with identical terms to that of the proposed affiliate agreement included in Rockwell's filing as Rockwell Exhibit 1.4.

Q. What are the two language revisions you recommend to the proposed affiliate agreement?

A. The first language revision is as follows (shown in underline/~~strikeout~~):

2.2. In determining the prevailing market rate to be assessed by RI for rendering of services to Rockwell as herein provided, RI shall charge no more than the rate RI charges unaffiliated companies for the same service. If the service provided is not offered to unaffiliated companies, RI must document to Rockwell that the rate is no greater than its fully distributed costs or rates charged to Rockwell is no greater than rates charged for similar services to other companies in the surrounding area of the service area of Rockwell.

This added language more clearly reflects that only RI's fully distributed costs

should be charged to Rockwell for RI's services which can be documented and provided to Staff in a rate or other type of proceeding. Rockwell stated in response to DR MHE 1.04 that it accepted this language revision.

The second language change recognizes that the Commission is the final authority on approval of any changes in the affiliate agreement. The current language allows either of the parties to terminate the agreement with 90 days notice to the other party. Rockwell agreed in its response to Staff DR MHE 1.05 to the following language change (shown in underline/~~strikeout~~):

4.1. This Agreement shall become effective as of the later of (a) the date first mentioned above or (b) the date the parties receive the last of any necessary approvals of governmental regulatory agencies having jurisdiction in the premises. Upon becoming effective, this Agreement shall be the sole agreement between the parties concerning the subject matter hereof and shall supersede all prior agreements, written or oral. This Agreement shall continue in full force and effect until terminated by either of the parties giving the other party hereto ninety days notice in writing, subject to ICC approval.

This language change conditions the termination upon approval of the ICC, which also ensure that Staff and the Commission is informed of substantive changes in the affiliate service agreement.

Q. Do you have conditions you are recommending that the Commission include in its order that are related to the affiliated agreement?

A. Yes. I have two conditions. The first condition is that Rockwell file a copy of the executed affiliate agreement with the agreed-to language revisions within one-

month of the date of the order in this proceeding on e-Docket and provide a copy of the executed affiliate agreement with the Manager of the Accounting Department of the Commission.

My second condition is that Rockwell be required to notify the Commission within one month of any such change described in Section 4.1 of the Agreement that would result in the termination of the affiliate agreement. This notification should be accomplished via a filing on e-Docket with additional copies of the notification provided to the Managers of the Accounting and Water Departments of the Commission.

Q. Please explain why it is necessary for your second condition to require notification to the Manager of Accounting of the Commission if the affiliate agreement approved in this proceeding becomes invalid.

A. This is necessary because the Agreement authorizes the affiliate to provide extensive services to the utility and the Commission should be aware of a possible compromise to the provision of safe and reliable utility service to customers.

The Commission had not been alerted that the current agreement had been terminated when the owner of Rockwell Utilities, Kirk, filed for bankruptcy protection on May 12, 2009. The service agreement had been rejected by operation of law in the Debtor's bankruptcy case. (Application, ¶7). Many essential services were to be provided by Kirk in the previous affiliate services agreement such as corporate administration, secretarial, accounting, information

systems, rates and revenues and human resources which includes labor to manage and operate the utility. (Rockwell Ex. 1.0 at 6, lines 100-103). The termination of the previous affiliate agreement meant that Rockwell Utilities could not perform services necessary to the provision of safe and reliable utility service unless it contracted with an outside firm, which it did according to the testimony of John Carroll.

Q. Do you have any other comments regarding affiliate transactions between the Company, Rockwell, and its new parent, RI?

A. Yes, I do. If Rockwell intends to engage RI to perform services, it must have an approved affiliate agreement prior to such transactions taking place. Rockwell cannot engage in any transactions with its RI until the reorganization and proposed affiliate agreement is approved by the Commission. Therefore, I recommend that the Commission approve the proposed affiliate agreement with RI as modified in Attachment A to my testimony and order Rockwell to comply with the two conditions.

Section 7-204(c) of the Act

Q. What are the requirements of Section 7-204(c) of the Act?

A. Section 7-204(c) of the Public Utilities Act states:

The Commission shall not approve a reorganization without ruling on: (i) the allocation of any savings resulting from the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated.

147 **Q. Please describe the Joint Applicants' proposal regarding the allocation of**
148 **savings resulting from the proposed reorganization and the recovery of**
149 **any costs incurred in accomplishing the proposed reorganization.**

150 A. In his testimony, Mr. Carroll states that Rockwell does not expect any savings as
151 a result of the reorganization. (Rockwell Ex. 1.0 at 8, lines 150-157). However,
152 Rockwell does propose to offset the costs of the reorganization, estimated to be
153 \$55,000, (id.), with any savings that might be realized. This is not consistent with
154 prior Commission treatment of this issue. In several previous orders, the
155 Commission has ruled that the costs incurred by a company as a result of
156 reorganization should not be passed to ratepayers. In Docket No. 06-0336, the
157 Commission stated:

158 ...the Commission concurs that the costs of the Proposed
159 Transaction are not recoverable in rates, and that, to the
160 extent that the Proposed Transaction results in any savings
161 in the test year of future rate cases, **such savings shall be**
162 **allocated in full to customers.** (Docket No. 06-0336, Order
163 dated June 27, 2007 *emphasis added*)

164 Additionally, in Docket No. 09-0268, Frontier Communications, the Commission
165 stated:

166 Regarding compliance with Section 7-204(c) the
167 Commission finds that the allocation of any savings resulting
168 from the proposed reorganization would flow through to the
169 costs associated with the regulated intrastate operations for
170 consideration in setting rates by the Commission in any
171 future rate request. ...**Therefore, the Joint Applicants**
172 **shall be prohibited from recovering all such**
173 **reorganization costs.** (Docket No. 09-0268, Order dated
174 April 21, 2010 p. 39)(*emphasis added*).

In Docket No. 00-0476 (Illinois-American Water Company, Citizens Utilities Company of Illinois and Citizens Lake Water Company, Petition for Approval of Proposed Reorganization and Affiliated Interest agreements, Issuance of Common Stock and Debt Securities and Assumption of Affiliated Interest Agreements, the Order at 37 (May 15, 2001) stated:

The Commission views the Acquisition Adjustment as a merger transactional cost that is not directly associated with the utility's provision of service. The Acquisition Adjustment is a cost associated with the "business end of the deal". Accordingly, the Acquisition Adjustment is ***not recoverable from ratepayers*** under the standard recently followed by the Commission in Docket Nos. 98-0555 (Ameritech/SBC) and 98-0866 (GTE/Bell Atlantic) (***emphasis added***).

Q. Please explain further your understanding of Rockwell's proposal.

A. In response to Staff DR MHE 1.06, the Company stated "Rockwell proposes to conduct and provide to Commission Staff an analysis of Rockwell Utilities' operating costs and possible savings, which will reflect one year of operations subsequent to closing the proposed transaction."

Q. Should Rockwell's proposal be adopted?

A. No. For several reasons, this proposal should not be adopted. First, as stated in the Commission Orders cited above, the Commission has not typically allowed a utility to recover transaction costs from ratepayers.

Second, depending on the test year selected for a rate proceeding, inclusion of these net costs could reflect out-of period costs and or savings that would not be appropriate for rate recovery.

Third, unless this analysis is presented in the context of a rate proceeding, it will have no effect on Rockwell's ratepayers. It is not appropriate for rate recovery.

Q. What ruling do you recommend the Commission make regarding (i) the allocation of any savings resulting from the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated.

A. I recommend that the Commission ruling find that (i) any savings that result from the reorganization will be reflected in future rate filings and rate proceedings of Rockwell; and (ii) no costs incurred in accomplishing the proposed reorganization will be eligible for recovery in a future rate proceeding.

Proposed Journal Entries

Q. Rockwell presented proposed journal entries to record its reorganization of the ownership interest of Rockwell Utilities LLC. By what criteria did you analyze the Company's proposed journal entries?

A. I analyzed the journal entries for compliance with the Uniform System of Accounts for Water Utilities, 83 Ill. Adm. Code Part 605 and the Uniform System of Accounts for Sewer Utilities, 83 Ill. Adm. Code Part 650 (together "USOA").

Q. Based upon your review, what do you conclude?

A. Since this transaction is a change of ownership of the utility, Rockwell's proposed journal entries should appear on the books and records of Rockwell Investments, LLC, not the water and sewer utility. With respect to Rockwell Utility, nothing regarding its assets has changed for ratemaking. In Docket No. 06-0522,

Rockwell Utilities, LLC's plant assets were recorded at original cost, and those plant assets should continue to be recorded at original cost regardless of this transaction.

Q. Please provide your rationale for your recommendation that Rockwell Utilities LLC should continue to record its plant assets in accordance with the original cost principle.

A. Definition 21 of the USOA defines original cost as "applied to utility plant, means the cost of such property to the person first devoting it to public service."

Pro Forma Statements of Income

Q. Did you review Rockwell's proposed pro forma water and sewer operating income statements?

A. Yes. Rockwell's pro forma water and sewer operating income statements appear to be based on reasonable assumptions and I found no reason to object to them.

Summary of Recommendations

Q. Please summarize your recommendations.

A. I recommend the Commission:

- 1) Find that Rockwell will be in compliance with Section 7-204(b)(2), such that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers;
- 2) Find that Rockwell will be in compliance with Section 7-204(b)(3), such that costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may

identify those costs and facilities that are properly included by the utility for ratemaking purposes;

3) Find that regarding the requirements of Section 7-204(c) that:

a) any savings that result from the reorganization will be reflected in future rate filings and rate proceedings of Rockwell; and

b) no costs incurred as a result of the proposed reorganization will be eligible for recovery in a future rate proceeding;

4) Approve the Affiliate Agreement as revised between Rockwell Investments, LLC and Rockwell Utilities, LLC with the following conditions:

a) Rockwell be ordered to file the executed affiliate agreement on e-Docket and to provide a copy of the executed affiliate agreement to the Manager of Accounting of the Commission within one-month of the order in this proceeding; and

b) Rockwell be ordered to notify the Commission within one-month of any such change described in Section 4.1 of the Agreement that would result in the termination of the affiliate agreement with copies of the notification provided to the Managers of the Accounting and Water Departments of the Commission;

5) Find that no journal entries are required on the records of Rockwell Utilities, LLC as a result of this transaction; and

6) Find that Rockwell continue to record its plant assets based on original cost.

268 **Conclusion**

269 **Q. Does this question end your prepared direct testimony?**

270 **A. Yes.**